

IN THE IOWA DISTRICT COURT FOR HUMBOLDT COUNTY

STATE OF IOWA, ex rel, THOMAS J.
MILLER, ATTORNEY GENERAL OF
Iowa,

Plaintiff,

vs.

SMITHFIELD FOODS, INC., and
PRESTAGE-STOECKER FARMS, INC.,

Defendants.

No. EQCV16629

ORDER, JUDGMENT AND
DECREE

* * *

A petition in equity (later amended) was filed on January 24, 2000. The sole defendant was Smithfield Foods, Inc. (Smithfield).

The genesis of the action was the announced acquisition by Smithfield of all the capital stock of Murphy Family Farms, Inc. (Murphy). It alleged that the acquisition would violate the provisions of Iowa Code section 9H.2 (1999); i.e., it is unlawful for a processor to own, control, or operate a feedlot in Iowa in which hogs are fed for slaughter. The original petition alleged that Iowa Code section 9H.3 provides that the attorney general of Iowa (IAG) (or a county attorney) shall institute suits on behalf of the state of Iowa to prevent and restrain violations. It asked the Court to issue a temporary injunction enjoining Smithfield from acquiring the Iowa assets of Murphy until it is established that it has complied with the statutory provisions. It requested the issuance of a preliminary injunction enjoining Smithfield from acquiring those assets; and to issue a permanent injunction after hearing and proof.

On the same date, this court, ex parte, granted the state's request for temporary injunction. It directed that Smithfield "be and is hereby temporarily enjoined from acquiring the Iowa assets of Murphy Farms, Inc., or the assets of any related entity located in Iowa until the Court rules on the plaintiff's motion for preliminary injunction." A hearing on the preliminary injunction (TRO) was set for February 10, 2000.

By agreement, the TRO was continued. Stoecker Farms, Inc. (Stoecker Farms), on or about January 24, 2000, had acquired the Iowa assets of Murphy. This prompted an amended petition filed February 4, 2000. It alleged that the Stoecker Farms/Murphy transaction, was a

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sham, accomplished for the sole purpose of permitting Smithfield to, in fact, control the feedlots (areas where hogs or cattle fed for slaughter are confined). It further requested the appointment of a special master to intensively investigate the transaction and to file a comprehensive report of his findings.

On February 9, 2000, an order was entered continuing the temporary injunction. It appointed Attorney Eric W. Lam of the Moyer & Bergman firm in Cedar Rapids to serve as the special master. Lam was vested with the power, authority, and responsibility to (1) regulate all proceedings before him, (2) administer oaths, (3) do all acts and take all measures appropriate for the efficient performance of his duties, and (4) compel production of any witness, party or document. The attorneys for the State, Smithfield, and Stoecker Farms approved that order as to its form and content.

On May 29, 2001, the state filed its second amended petition. It alleged that William Prestage, a director of Smithfield, had acquired 51% of the stock in Stoecker Farms; and that transaction further identifies the violation of Iowa Code section 9H.2. It was accompanied by a renewed request for a temporary injunction and/or appointment of a receiver.

Smithfield and Stoecker Farms jointly moved to dismiss that amended petition. That motion was set for hearing for June 22, 2001. Subsequently, by approval of court, the state withdrew its second amended petition. The defendants withdrew their motion to dismiss. The State filed a substituted amended petition on June 27, 2001. It added Prestage-Stoecker Farms, Inc. (P-S Farms), as a defendant, as successor to Stoecker Farms. The state requested equitable relief to (1) continue the appointment of Lam; (2) require P-S Farms to disgorge all its holdings; (3) prohibit Smithfield from the operation or control of Iowa feedlots; and (4) provide such other relief as just and proper.

On July 12, 2001, the parties jointly filed a detailed and lengthy "First Set of Stipulated Facts." In its answer to the substituted petition, Smithfield alleges (1) the State's failure to state a claim upon which relief can be granted; (2) Iowa Code section 9H.2 is an unconstitutional exercise of legislative power under the due process, equal protection, commerce, and takings clause of the federal and state constitutions; (3) 9H.2 is unconstitutionally vague; (4) waiver and estoppel; (5) Smithfield's full compliance; and (6) the IAG exceeded its scope of authority. P-S Farms filed a similar answer and similar affirmative defenses, by different counsel.

The defendants jointly moved to strike the request for the remedy of disgorgement as not a statutory remedy under Chapter 9H. The State filed a formal resistance.

After a series of postponements, for cause, the special master, on October 12, 2001, filed his first (and final) report. It is in appropriate form, enveloping 35 pages. After entering an order relating to a briefing schedule, the Court eventually set a hearing upon the receipt of Lam's report, pursuant to our rules, to consider it together with any further factual addenda offered by the parties. The parties entered into a stipulation, filed November 2, 2001, concerning its submission and use. The parties agreed to file briefs on the "sham" issue and the additional issue of the applicable burden of proof. The parties further agreed that the Court, in its discretion, may (or may not) use and rely on selected facts from the record, though not included or referenced in the master's report. That stipulation was APPROVED. The hearing and this ruling are pursuant thereto.

A hearing was held on Friday, January 11, 2002. The Court heard the presentations and arguments of counsel. By agreement, it was transcribed by the court reporter. Copies were distributed to the Court and counsel. There are some references to it by book and page herein.

Appearing for the state were Assistants Attorney General Gordon Allen, Stephen Moline, and Steven Reno; appearing for Smithfield Foods was Warren E. Zirkle, Richard Cullen, and Brian P. Rickert; and representing Prestage-Stoecker Farms was Robert P. Malloy.

* * *

Iowa Code section 9H.2 provides:

"In order to preserve free and private enterprise, prevent monopoly, and protect consumers, it is unlawful for any processor of beef or pork . . . to own, control, or operate a feedlot in Iowa in which hogs or cattle are fed for slaughter."

It is conceded that Smithfield processes pork products, and for each of the past fiscal years, its sale of pork products exceeded an annual wholesale value of \$10 million, the statutory minimum. It is, in fact, the largest hog producer and pork processor in the world.

On September 2, 1999, Smithfield announced that it intended to acquire all of the capital stock of Murphy Family Farms, Inc. (Murphy), for approximately 10 million shares of Smithfield common stock and the assumption of approximately \$170,000,000 of Murphy's term debt and other liabilities.

Murphy is a North Carolina corporation. It was one of the nation's largest hog producers. It was a party to grower contracts with about 200 Iowa producers wherein the growers agree to care for and feed Murphy's swine for a fee. Murphy filed U.C.C. financing statements against the growers to provide public notice that the hogs belonged to Murphy, not the growers.

Murphy has two divisions: North Carolina and the Midwest. The midwest division began operations in about 1991 to take geographic advantage of lower feed costs and, therefore, lower production costs in Iowa. It started with 1700 sows which has grown to approximately 300,000 sows at this time. Murphy also operated facilities in its midwest division in Illinois, Kansas, Minnesota, Missouri, South Dakota and Texas. But 75% of Murphy's midwest operations were concentrated in Iowa.

On September 3, 1999, the IAG sent a letter to Smithfield informing it that an acquisition of all or part of the Iowa assets of Murphy may violate the provisions of Iowa's corporate farming law found in Iowa Code chapter 9H. In its letter, the IAG expressly requested Smithfield to provide documentation establishing any reasons the acquisition would not violate Chapter 9H.

On December 3, 1999, the IAG sent a second letter to Smithfield restating its concerns regarding the acquisition. Smithfield had stated in previous telephone conversations that the merger was scheduled to be completed on January 1, 2000. The IAG accordingly asked Smithfield to provide its documentation establishing that the acquisition would not violate Iowa Code 9H by no later than December 13, 1999.

On December 17, 1999, Smithfield responded to the IAG's request for documentation concerning the intended acquisition. Part of Smithfield's response included assurances that the acquisition would not be completed until sometime later in January 2000.

At a special meeting of Smithfield's shareholders on December 21, 1999, the shareholders approved the issuance of approximately 10 million shares of Smithfield common stock to acquire the capital stock of the several Murphy corporate entities. Upon consummation of the acquisition, Murphy would become a wholly-owned subsidiary of Smithfield. During 1998-1999, Murphy had suffered operating losses. During those same years, Smithfield had enjoyed net positive income. The acquisition was viewed as serving Smithfield's continuing strategy of vertical integration into hog production.

One of the conditions to consummation was that "there must not be any law or order or any action taken by any court . . . prohibiting or restricting the acquisition or making it illegal."

Discussions were held between the parties in an effort to resolve this matter absent formal legal proceedings. However, on January 21, 2000, counsel for Smithfield informed the IAG, by letter that it could not assure that the referenced acquisition could be delayed after January 25, 2000.

On January 20, 2000, Stoecker Farms, Inc., filed its articles of incorporation, minutes of informal action by the consent of the incorporator of Stoecker Farms, Inc., minutes of its organizational meeting, and bylaws of Stoecker Farms, Inc., with the Iowa secretary of state. Stoecker Farms, Inc.'s incorporator was Christopher R. Sackett, and its registered agent was Steven C. Schoenebaum. Each was a Smithfield lawyer from Des Moines. Randall D. Stoecker was identified as the sole stockholder, director and officer of Stoecker Farms, Inc.

Pursuant to those bylaws of Stoecker Farms, Randall Stoecker initially contributed \$10,000 as consideration for the issuance of 100 shares of common stock. This \$10,000 investment comprised the total equity of Stoecker Farms at its formation. That sum was deposited into a bank account in Kossuth County by a check from Randall Stoecker. Prior to January 20, 2000, Randall Stoecker had been employed by Murphy. On January 20, Stoecker resigned his position with Murphy.

On January 24, 2000, the IAG filed this action, and the TRO was entered.

On that same date, pursuant to the asset purchase agreement, Stoecker Farms purchased the Iowa assets of Murphy. The purchase price was set at \$72,000,000, paid by the delivery of a promissory note in that amount to Murphy by Stoecker Farms. Those assets included Murphy's Iowa grower contracts, feeder pig and hog inventory, feed and medical supplies, and an assignment of Murphy's IBP sales contract. That contract provided that IBP would pay Murphy market price for quality 220-lb. butcher hogs, plus a premium of \$2.00 per head. At all relevant times, the sites identified in the Iowa growers contracts where swine have been, and continued to be fed, are "feedlots" as defined in Iowa Code section 9H.1(12).

The \$72,000,000 note was secured by a written security interest granted by Stoecker Farms dated January 24, 2000. The security agreement secured the "obligations" of Stoecker Farms defined as ". . . (a) the note and any extensions, modifications, supplements, increases or

renewals thereof, and (b) any obligations to the lender of the borrower or any party under the purchase agreement." The security agreement included language in its default provision irrevocably appointing the lender as the borrower's attorney-in-fact for certain specified purposes to be exercised "while an event of default has occurred and is continuing." An event of default is defined, in the security agreement, as "any event constituting an event of default under any of the loan documents and includes, without limitation, any breach by the borrower of any representation, warranty, covenant or agreement made by the borrower under this security agreement."

Also, on January 24, 2000, Stoecker Farms and Murphy entered into an assignment and assumption agreement pursuant to which Murphy assigned its interests in its Iowa grower contracts to Stoecker Farms. The Iowa grower contracts have not been modified in any way from the time of assignment to the present.

In order to comply with the injunction, Murphy on January 24, 2000, also sold to Stoecker Farms its remaining Iowa assets. The supplemental assets were Murphy's Iowa feed mill and office lease, rolling stock and vehicles, office and other equipment and other tangible property. The purchase price for these assets was \$7,384,288, paid by the delivery of a promissory note in that amount to Murphy by Stoecker Farms. Randall Stoecker has not personally guaranteed any of the debts of Stoecker Farms.

On January 28, 2000, Smithfield acquired the stock of Murphy. The purchase price was paid in 11.1 million shares of Smithfield common stock and Smithfield's assumption of \$203,000,000 of Murphy's outstanding debt plus other liabilities. Because Murphy owned no Iowa assets at the time, the acquisition of Murphy's stock by Smithfield did not violate the injunction by stipulation of the parties.

On January 28, 2000, Murphy and Stoecker Farms entered into a feed pig purchase agreement. Pursuant to the agreement, Murphy delivers and Stoecker Farms purchases feeder pigs in quantities necessary to maintain full capacity of Stoecker Farms' contract grower facilities. The terms of the feeder pig purchase agreement have remained in place and unchanged from January 28, 2000, to the present.

On January 28, 2000, Stoecker Farms and Murphy entered into a "Service Agreement." Pursuant thereto Murphy agreed to assign employees of Murphy who, prior to the purchase, performed the services necessary to operate the Iowa operation of Murphy, to Stoecker Farms.

The assigned employees, by agreement, remain employees of Murphy. Murphy is an alleged independent contractor providing services to Stoecker Farms. The service agreement remains in effect as of the date of the filing of the stipulation on July 12, 2001.

Randall Stoecker remains the only employee of Stoecker Farms other than the assigned employees working for Stoecker Farms under the services agreement with Murphy. Randall Stoecker has the final supervisory authority for the assigned employees both as the CEO of Stoecker Farms and as manager of the midwest operations for Murphy. On February 23, 2000, Stoecker was rehired by Murphy (then a wholly-owned subsidiary of Smithfield) as a part-time employee to manage Smithfield's non-Iowa midwest operations at a reduced salary, but with normal benefits, retroactive to February 1, 2000.

On February 23, 2000, Murphy and Stoecker farms agreed to correct the face amount of the inventory note from \$72,000,000 to \$58,000,000. The terms were amended to provide that the amount due under the note for the feeder pig and hog inventory sold to Stoecker Farms on January 24, 2000, would be the actual net proceeds realized from the sale of that inventory calculated in the manner provided in the feeder pig purchase agreement.

On February 24, 2000, Murphy and Stoecker Farms agreed, subject to this court's approval, the transactions "contemplated by the supplemental asset purchase agreement will be rescinded, in whole or in part, to the extent permissible, effective retroactively to January 28, 2000. In the interim, no payments need to be made on the note delivered by Stoecker under the supplemental asset purchase agreement, which payments shall accrue until we see where this matter ends up." On April 18, 2000, this Court entered an order, with the consent of the IAG, granting the defendant's motion to modify the temporary injunction. It removed the assets identified in the supplemental asset purchase agreement from the prohibitions contained in the temporary injunction entered on January 24, 2000. The sale of the supplemental assets (feed mill, etc.) was rescinded. On February 24, 2000, IBP formally consented to the January 28, 2000, assignment by Murphy to Stoecker Farms of the IBP sales contract.

On February 29, 2000, Randall Stoecker agreed to contribute additional capital, in an amount sufficient to bring his total cash contributions to \$500,000 (an additional \$490,000). Stoecker agreed to infuse the additional equity within sixty days. In the interim, the parties engaged in settlement discussions that extended over several months. As a result of those settlement negotiations, the injection was understandably delayed, though Randall Stoecker was

willing, ready and able to inject the \$500,000 after May 1, 2000. On November 15, 2000, Randall Stoecker did make the capital contribution of \$500,000 to Stoecker Farms in exchange for 5000 shares of stock at a par value of \$100 per share.

On February 29, 2000, the defendants provided the State of Iowa with the following: (1) Stoecker Farms' feeder pig purchases calculations; (2) Stoecker Farms' accounting summary of February 20, 2000; and (3) Stoecker Farms' pro forma financial statements for calendar years 2000-2002. While market prices have changed, the information contained in the feeder pig purchases calculation examples accurately reflects the basic elements of the business transactions described from February 29, 2000, to July 12, 2001.

On November 30, 2000, Murphy and Stoecker Farms entered into an "Agreement to Amend and Restate Term Note." The agreement states that "Stoecker Farms has made all payments thereunder and has further anticipated the payment of principal thereunder such that the outstanding principal balance of the term note has been reduced to \$9,112,593 as of this date." Stoecker Farms had agreed to pay the principal amount of the restated note down to \$9,000,000 and the parties, seller and buyer, agreed to reamortize the term note over the remaining months of its original term effective January 1, 2001.

On November 30, 2000, Stoecker Farms and Murphy entered into an "Amended and Restated Security Agreement" securing Stoecker Farms' obligations to Murphy. Stoecker Farms' obligations are defined as (a) "the amended and restated note and any extensions, modifications, supplements, increases, or renewals thereof, and (b) any other obligations to the lender (Murphy) of the borrower (Stoecker Farms)."

Both the original security agreement and the amended/restated security agreement provide that "if any event of default has occurred and is continuing, the lender (Murphy) may exercise all rights of a secured party under the UCC." The amended and restated security agreement does not contain language establishing Murphy as Stoecker Farms' "attorney-in-fact" in certain instances as provided in the original security agreement.

On January 24, 2001, Smithfield and Stoecker provided the State with copies of Stoecker Farms' financial statement summary through December 2000. On the same date, the State was provided with copies of the Stoecker Farms' sales journal and Stoecker Farms' check register for calendar year 2000. On January 24 and February 8, 2001, the State was provided copies of Stoecker Farms' cancelled checks for March, August, November and December 2000.

Pursuant to the services agreement, Stoecker Farms has contracted with Murphy for assigned employees, including Dennis Neutzman, to perform all of its accounting and financial operations. These operations are overseen by Dennis Neutzman. Neutzman devotes on average 50 percent of his time to Stoecker Farms under the services agreement. The remaining portion of his time is devoted to Murphy as its director of finance for its midwest operations. Stoecker Farms does not have any employee whose job description includes responsibilities to audit the accounting done by the assigned employees. The accounting firm of McGladrey & Pullen has conducted a financial statement audit of Stoecker Farms. It has issued an opinion that those statements were prepared in accordance with generally accepted accounting principles (GAAP).

Stoecker Farms' operations from February 2000 through December 2000 grossed \$241 million, involving almost 2,000,000 head. At the conclusion of 2000, Stoecker Farms showed a net retained income of \$527,000 before taxes.

On or about May 17, 2001, Randall Stoecker sold 51 percent of his shares in Stoecker Farms to William Prestage (Prestage). The terms of the sale were memorialized in a stock purchase agreement and a stockholder's agreement. The purchase price paid by Prestage was \$559,000, an amount equal to the book value of the transferred shares plus 10 percent. On June 14, 2001, the name of Stoecker Farms was changed to Prestage-Stoecker Farms, Inc. Its board of directors consists of Randall Stoecker and Prestage's two sons. Randall Stoecker remains as its CEO.

Prestage serves on Smithfield's board of directors. There are nine directors, including the CEO. He owns roughly 800 shares of Smithfield stock. A corporation owned by him owns approximately 120,000 more shares. There are about 46 million shares of Smithfield stock outstanding. Prestage is from North Carolina. He has an option to purchase the remaining 49% of Prestage-Stoecker Farms, Inc. Prestage made available a \$2 million unsecured working capital line of credit. Prestage has the financial strength to completely pay off P-S Farms' unsecured debt to Murphy; i.e., about \$9 million as of December 2000. Randall Stoecker approached Prestage about his interest in a stock acquisition. Stoecker had concluded this litigation had retarded the growth of Stoecker Farms. Stoecker had more interest in working with growers than tending to litigation and the capital needs of Stoecker Farms. Since Prestage had the expertise in the swine industry, and the financial wherewithal to weather the protracted litigation, Stoecker searched Prestage out.

As a part of the stipulation, filed July 12, 2001, the State, through the IAG, agreed that (1) Smithfield has not been involved in the manufacturing, processing or preparation for sale of pork products derived from swine produced by Stoecker Farms from January 2000 to the date of the stipulation; (2) all swine grown on Stoecker Farms' feedlots have been sold to IBP who performed the manufacturing, processing and preparation for sale of pork products derived from its swine; (3) before the sale by Murphy to Stoecker Farms on January 24, 2000, Murphy did not violate Iowa Code section 9H by contracting for the care and feeding of swine in Iowa on feedlots owned by Iowa growers under the grower contracts; and (4) since the sale by Murphy to Stoecker Farms, Stoecker Farms has continued to contract for the care and feeding of swine in Iowa by the Iowa growers without material change in such contracts or their administration.

* * *

Firstly, the Court has closely read the special master's report. Lam appropriately, exhaustively and ably delved into all the probative facts which surround this complicated issue. The Court accepts the master's findings of fact. It further finds that none of those facts are clearly erroneous. As a part of that conclusion, the Court has relied on facts from the record to corroborate those findings.

The State admits that "there are really no or very few factual disputes. . . There's no question about which statute applies in this case. . . Really the only question is can you apply 9H to these facts. . . and how this deal transpired." (Tr. p. 23, ll. 17-24)

Two legal issues remain. First is the appropriate legal standard of proof to be applied to measure the State's allegation that this Murphy/Smithfield transaction with Stoecker Farms (now P-S Farms) was accomplished for the sole purpose of creating an appearance of compliance by Smithfield with Iowa Code section 9H.2; and secondly, whether the Murphy/Stoecker transaction was a "sham."

The State contends that whether a transaction constitutes a "sham" requires this Court to look at all the equities of the case. As a remedy, IAG requests this Court to declare these transactions and resulting operations a "sham," under its equitable powers, and to further find that all the transactions with Stoecker were calculated to avoid the effect and wrath of the legislation, but yet control the revenues and profits.

The State, in argument, suggests that Smithfield has created a shell, albeit a legal one; that it has carefully prepared all the documents, dotted all the I's and crossed all the T's; but that

it was all done with the aim of surreptitiously making an end-run on our statute; and that the courts cannot let this occur in this regulated industry. The State contends that Smithfield had two economic objectives: (1) retain the money; and (2) to avoid the consequences of Chapter 91H. The State asserts Smithfield succeeded in the first, but this action should stymie its success on the second.

Smithfield/Stoecker asserts that in January 2000 it was faced with compliance with a temporary restraining order which enjoined Smithfield from acquiring any Iowa assets of Murphy's; that it was Smithfield's intent to comply (rather than to avoid) with the legislation and the TRO, that nothing occurred in this transaction that vertically integrated the Iowa operation; the only processor involved was IBP, whose involvement is not contrary to the statute; the legislature did not intend to reach this type of situation; Smithfield's only involvement is to supply feeder pigs to P-S Farms from its sow farms located outside of Iowa, which is not prevented by the statute, and the State does not contend is improper; it is very clear that Smithfield does not control, operate or own the feedlots; that "revenues" are not mentioned in the statute; and Lam has found that "there is no documentary or testimonial evidence of any direct or indirect control or influence by Murphy/Smithfield over Stoecker's operation." (No. 60, p. 27).

Smithfield admits that it is receiving value for the feeder pigs that it supplies; i.e., IBP buys the hogs, the money goes to P-S Farms, the growers are paid, the miscellaneous expenses are paid for hauling, vet services, feed, etc.; the contract employees are paid; P-S Farms retains 25 cents per head; and the balance is paid to Murphy/Smithfield for its feeder pigs. But it contends it is not controlling the revenues, nor does it have the ability to control the costs that reduce these revenues; that this is a cost-plus contract in common use in American agriculture; that vertical integration is the ability of a processor to control two or more steps in the production and distribution chain, and Smithfield, through Murphy, is only selling feeder pigs and is not controlling the production of the feedlots where they are raised, nor is it slaughtering the animals.

* * *

Lam broke down his factual findings into two divisions: (A) facts tending to support the State's "sham" theory (1-36); and (B) facts tending to support Smithfield/Stoecker's theory of no "sham" (37-65).

An abbreviated listing of those facts to support the State's sham position is as follows:

(1) The same personnel (Murphy's employees) supervise and work with the growers before and after the transactions; their paychecks bear Murphy's name; Stoecker Farms does not have its own procedures and manuals; it uses those developed by Murphy;

(2) Murphy is the sole source of supply of feeder pigs to Stoecker Farms, with little exception;

(3) Until Prestage's investment, Murphy was the sole source of financing for Stoecker relative to the purchase of the feeder pigs;

(4) Murphy is practically the sole source (85%) of feed for Stoecker Farms;

(5) Smithfield's in-house counsel and its Des Moines law firm performed all the incorporation legal work which resulted in the formation of Stoecker Farms; Randall Stoecker signed all the incorporation paperwork without hiring his own counsel for review or comment; the choice of a subchapter S corporation vis-à-vis a regular C corporation, for tax purposes, was made by Smithfield's counsel or personnel without any consultation or knowledge by Randall Stoecker;

(6) Murphy did not consider or contact any person, other than Stoecker, to purchase the grower operations in Iowa;

(7) Randall Stoecker owns at least two farms in North Carolina which are financed and operated by Murphy; Stoecker was indebted to Murphy for about \$500,000, secured by mortgages on the North Carolina farms; the farms are collectively worth about \$4 million; Stoecker's sow farms are operated by Murphy personnel in North Carolina; their income was used to repay Murphy on the mortgages; up to May 2000, Stoecker and Murphy had not only an employer-employee relationship, but also a lender/borrower relationship;

(8) Prior to 1-20-2000, Randall Stoecker had been employed by Murphy as the manager of its midwest operations; he resigned, but on 2-23-2000, he was rehired by Murphy (then owned by Smithfield) as a part-time employee to manage Murphy's non-Iowa midwest operations at a reduced salary, but with normal benefits, effective 1-1-2000;

(9) Murphy does not charge Stoecker Farms any interest or finance charges for the purchase of the 15-40 lb. feeders. The feeders take approximately 17 weeks to market; Stoecker Farms does not pay anything until they are marketed (at roughly 220 lbs.), and even then, Stoecker Farms does not pay any interest; the Murphy/Stoecker transaction is akin to a partnership; Smithfield's financial officer characterized the relationship as one of a "partner,"

and also described Smithfield as an investor in the Iowa operation; i.e., Smithfield and Stoecker Farms were two businesses working toward a common goal;

(10) All costs of raising the hogs are borne by Murphy, pursuant to the formula contained in the feeder pig purchase agreement;

(12) All finished hogs are sold to IBP, the same sale outlet used before these transactions;

(13) Neutzman, a long-time Murphy employee, serves as Stoecker Farms' accountant and financial analyst; his supervisor at Murphy is Randall Stoecker;

(14) Randall Stoecker received a \$210,000 salary from Murphy in 1999; after the Murphy/Stoecker transaction, he receives \$115,000 from Murphy and \$265,000 compensation from Stoecker Farms, a total of \$380,000;

(15) Stoecker Farms, as of 3-1-2000, was capitalized by a \$10,000 infusion by Randall Stoecker; Stoecker entered into a \$58 million transaction with Murphy; Randall Stoecker, until his \$500,000 capital injection in November 2000, had but \$10,000 at risk for about nine months;

(16) The Murphy/Stoecker borrowing was not accompanied by a Stoecker Farms corporate resolution, though required by its bylaws;

(17) The documentation, drafted solely by Smithfield's counsel, appeared drafted in haste; it contained several errors, and was not corrected for many months; the bill of sale for \$72 million did not contain any warranty or representation whatsoever; warranty deeds from Murphy to Stoecker Farms were delivered without the existing mortgages being released; and though Stoecker Farms granted Murphy a lien on the hog inventory, the lien was not perfected until March 2000;

(18) The State's expert opined that an inventory cash sale would ordinarily require a cash injection of 20-30%, but this Murphy/Stoecker Farm transaction was 100% financed, with nothing up front;

(19) The growers' contracts provided they may not be assigned without the grower's individual permission; the assignment from Murphy to Stoecker Farms was not accompanied by any grower's permission;

(20) A fixed 8% interest rate for a ten-year term on a \$72 million note, involving inventory which fluctuates in value, would be atypical;

(21) Smithfield's expert opines that the Stoecker Farm debt to asset ratio of .098 to 1.00 (before Prestage) was poor, considering that the purchase was 100% financed and the hog market

is subject to many variables for price and diseases. The State's expert stated that a financing bank would have a short-term balloon so the interest rate could be adjusted due to the huge sums involved; that the absence of a personal guarantee was atypical; and all the risk was borne by Murphy;

(22) Stoecker Farms did not procure assistance of counsel, again atypical;

(23) The term note was reduced \$14 million due to a misunderstanding as to the number of hogs; and though the note, by its terms, was to be repaid over several years, Smithfield/Murphy expected to be repaid in "short order;"

(24) The \$72 million note was rapidly paid down ahead of schedule;

(25) Murphy did not take Randall Stoecker's shares of stock in Stoecker Farms as security;

(26) Smithfield's CEO had never seen "a deal like this" and it is "highly unusual;" the State's expert stated it was "very abnormal and unusual;" and an officer of Murphy's stated Murphy is in the business of raising pigs, and not in the lending business;

(27) When the issue of Chapter 9H surfaced, Smithfield/Murphy diagramed, designed, memorialized, and implemented the Murphy/Stoecker Farms transaction to make sure the profit opportunities were captured, contained, and controlled, recognizing no bad motive but the motive of making a profit;

(28) Though the IBP marketing contract is extremely favorable, Murphy's witness testified that no value was placed on it in the asset purchase agreement; also, IBP did not consent to it until February 24, 2000, though its consent was required;

(29) Murphy had routinely obtained individual personal guarantees from its contract growers; it did not obtain a personal guarantee by Randall Stoecker on the \$72 million asset purchase agreement which was 100% financed;

(30) Though no Stoecker financial statements were obtained by Murphy, Murphy employees, doing the financials, were working for Stoecker Farms;

(31) Stoecker Farms (prior to Prestage) had no liquidity to buy feed or engage employees from sources other than Murphy;

(32) Bill Prestage now owns 51% of Stoecker Farms and remains on Smithfield's board of directors; and though there are three directors on P-S Farms' board (including Prestage's two sons and Randall Stoecker), Prestage testified that Randall Stoecker's view would prevail;

(33) Murphy could and did access Stoecker Farms' bank account, which the accountant views as an internal control weakness; a fund transfer was initiated Murphy to Murphy though Stoecker Farms would first tell Murphy how much money could be extracted;

(34) Murphy, with or without Stoecker Farms (or P-S Farms) continues to carry the economic risks of the pork production;

(35) Until the Murphy debt is paid off, Stoecker Farms' profit is capped at \$ 25 per market hog; through 12-31-00, the number of marketed hogs would warrant a payment of \$479,941; and Stoecker Farms had retained income of \$527,303;

(36) An expert stated that a typical equity requirement cushion would be 20% to 30%, and Stoecker Farms did not have an economic safety net in order to operate;

An abbreviated listing of those facts to support the theory of Smithfield and Stoecker Farms that no sham exists:

(37) Stoecker Farms has its own books, records, bank accounts, and corporate formalities; it has its own auditor, produces its own financial statements, which were not shared with Murphy until discovery; and its auditor opined that Stoecker Farms is an independent entity as measured by GAAP;

(38) Murphy lost money by giving up \$0.25 per market hog, which in 2000 was about \$500,000; though Murphy was paid about \$150,000 for the use of their contract employees, Murphy still lost about \$350,000;

(39) After the term note has been paid off, Stoecker Farms will not pay any interest; the money saved can be freed up and used for its own benefit;

(40) The total capital injection of \$510,000 by Randall Stoecker is more than sufficient; its source is the pledge of Randall Stoecker's North Carolina sow farms to the Farm Credit System; he has used part of the loan proceeds to pay off the \$500,000 mortgage then held by Murphy against those sow farms; Randall Stoecker has available to him a \$4 million line of credit from Farm Credit and is willing and able to inject that sum into the P-S Farms operation; as of 12-31-00, \$241,434,472 of revenues were generated by Stoecker Farms; the initial term note of \$58 million was paid down to about \$9 million at the end of the year 2000, principally paid by the sale of the inventory of feeder pigs on hand at the time of the sale; and despite the

internal drafting inconsistencies (later corrected), the Murphy/Stoecker transaction was documented by traditional notes and security agreements;

(41) Randall Stoecker set his own "draw" or "salary" from Stoecker Farms, without input or influence from Murphy;

(42) Smithfield's experts possessed more expertise in the areas of capital contribution and working capital than the State's expert; they concluded that both the equity contribution and the working capital were sufficient;

(43) Stoecker Farms' working capital, defined as available cash + accounts receivable -- trade payables -- current portion of long-term debt, has continued to improve, and the defendants' experts opined that Stoecker Farms has sufficient capital to conduct its business affairs;

(44) Randall Stoecker is more knowledgeable about the feeder pig growing techniques than anyone at Murphy and/or Smithfield, each of whom rely on his expertise; Randall Stoecker developed the "Iowa model;" in this sense, Randall Stoecker "controls" Murphy, not vice versa;

(45) Murphy and Randall Stoecker talked briefly about the possibility of the latter taking over Murphy's Iowa operations in September 1999; this contact shows that the Stoecker Farms/Murphy transaction was contemplated before the Iowa Code Chapter 9H issues surfaced;

(46) Randall Stoecker is genuinely qualified and knowledgeable about the hog industry; he holds a degree in agricultural economics and has worked as a banker, feed salesperson, innovator in hog genetics, and in other agri-business ventures;

(47) Randall Stoecker is free to develop his own growing procedures or systems and is not bound by contract to follow or adopt any Murphy or Smithfield procedures or methods;

(48) Stoecker Farms is free to purchase feed and the feeders from anyone; roughly 15% of Stoecker Farms' feed purchases came from Farmland and other non-Murphy/Smithfield entities;

(49) Randall Stoecker is free to change the subchapter S status of Stoecker Farms;

(50) Stoecker Farms does and did contract with "seasonal growers" who "grow" at least 40,000 animals for Stoecker; that is, the Murphy contract growers were not the sole providers of the roughly 2 million animals to Stoecker Farms during 2000;

(51) No grower has complained about the Murphy/Stoecker Farms transaction or left the program; several new growers have joined and two or three existing growers have expanded;

(52) Stoecker Farms is free to use any personnel and is not bound by contract to only use Murphy employees;

(53) Stoecker Farms could suffer a loss, notwithstanding the \$2.00 a head premium from IBP, as there may be no dollars left for Stoecker Farms after payment of feed, medication, overhead, etc.;

(54) The Murphy/Stoecker Farms transaction had to be implemented within a very small time window; there was a great deal of time pressure exerted on the parties to consummate the transaction, in order to comply with this Court's 1-24-2000 injunction; there was considerations of the Hart-Scott-Rodino Act, dealing with anti-trust issues, the price of the Smithfield stock was declining, and additional time pressure arose to consummate the deal to provide the least adverse tax consequences to the Murphy shareholders; and all the parties' personnel, counsel and financial advisors were scrambling to implement the transaction, which may have been the reason for the numerous typos;

(55) It is not uncommon for a business transaction to have technically "closed" only to be amended or refined at a later time; and typos and internal inconsistencies are not unusual in loan and closing documents similar to these;

(56) Any early accounting confusion was understandable, given the compressed time frame;

(57) It is not unusual that the buyer continues to engage and employ the same personnel post-sale as the seller, in order that the customer base of the business does not have to suffer through a learning curve;

(58) Rapid debt reduction is a sound business practice; there is no evidence of any pressure from Murphy directing Stoecker Farms to pay the term note rapidly;

(59) The Murphy/Stoecker Farms transaction is a seller-financed event, and traditional bank financing principles have little applicability; the Murphy/Stoecker transaction bore an "earn-out" character as the value of the IBP contract is captured in the feeder pig purchase agreement, and the attendant formula; Randall Stoecker, for Stoecker Farms, without input from Murphy, assisted the growers to overcome high propane prices by paying those growers \$25,000; that payment reduced the amount of money that went to Murphy; Randall Stoecker also instituted a new program, known as "wean-to-finish," when young pigs, as opposed to feeders, were placed into the grower houses, which is an experiment or a new growing method;

(60) There is no documentary or testimonial evidence of any direct or indirect control or influence by Murphy/Smithfield over Stoecker Farms' operation;

(61) There has not been any actual incident of conflict by the Murphy employees performing work for Stoecker Farms; and Randall Stoecker states that if it does occur he will resign;

(62) The internal control weakness, referenced at No. 33, was immediately addressed and corrected; no withdrawal in excess of the authorized amount ever occurred, and Murphy could not initiate the fund transfers after the auditor had brought it to their attention;

(63) By a separate supplemental asset purchase agreement, Murphy sold its Iowa feed mills and rolling stock to Stoecker Farms, with the purchase price paid by the delivery of a \$7,380,000 note; that supplemental agreement was rescinded by approval of the court; and there is no evidence that Stoecker Farms intends to reassign the assets back to Smithfield/Murphy after the resolution of this lawsuit;

(64) Although Murphy/Smithfield has the right, per the security agreement, to repossess the secured assets and to take over the grower operations, because of the prohibition imposed by Iowa Code Chapter 9H, it is unlikely Murphy/Smithfield could repossess and own the pledged assets anyway;

(65) Prestage used his own money to purchase 51% of Stoecker Farms and is willing and able to inject additional funds to pay off the remaining \$9 million in principal; there is no evidence of any control, influence or suggestion exerted by Smithfield/Murphy on Prestage to engage in the stock purchase, nor any similar pressure exerted on Randall Stoecker to allow Prestage to become a majority owner of the corporation's stock; Prestage was pursuing his own profit motive; and Prestage indicated he will resign from Smithfield if any conflict arises.

* * *

The parties agree that there are two legal issues before the Court: (1) the requisite burden of proof to substantiate a legal "sham;" not surprisingly, the State asserts its burden is a preponderance of the evidence, whereas the defendants assert it is a preponderance of clear, convincing and satisfactory evidence; and (2) whether the transactions effected by the defendants constitute a legal sham.

The State, in argument, contends that the first issue, while strongly argued by both defendants, is a red herring; that the standard of proof is a moot point because the true intent of

the defendants' conduct has been admitted by them; that is, it was their intent throughout to maintain profits, while still complying with the statute and this Court's injunctive order. The State contends that, while there are the two issues, whether this is a sham, addressed under the Court's equitable powers, is the only real substantive issue remaining (Tr. p. 5, ll. 5-23).

Prestage-Stoecker Farms, in response, argues that the Court needs to get to the factual issues of the sham, which will reflect that there has been compliance with Chapter 9H (Tr. p. 6, ll. 1-9). Smithfield's position is that the facts are clear that it is not a sham under either standard, and, though it is not a red herring, it is moot because the proof does not lie even upon application of the lower standard (Tr. p. 6, ll. 20-24).

The parties agreed that in determining whether or not there is a sham, the Court should take the findings of fact from Lam, and such additional findings of fact that the Court may selectively excerpt, if at all, from the other material (Tr. p. 17, ll. 6-12).

The State admits that there is no definition in our state law of sham; that to find a sham is within this Court's discretion and its equitable powers (Tr. p. 21, ll. 6-16). The State agrees that, without a definition, Webster or Black affords some help (Tr. p. 22, ll. 4-16). Black's Law Dictionary (Seventh Edition - 1999) defines the noun "sham" as "something that is not what it seems; a counterfeit; a faker." Webster (1989) defines it "as someone who pretends to be what he is not."

The State proposes that the Court apply the principles emanating from two optometric cases: State v. Plymouth Optical Company, 211 N.W.2d 278 (Iowa 1973); and State v. Kindy Optical Company, 248 N.W. 332 (Iowa 1933). These two cases did not define sham. The State agrees that although the legal documents were in order and not counterfeit, the court, in essence, stated the intent was to avoid the statute which one cannot do in the regulated optical industry. The State asserts that regardless of "all the trees that we've killed in this case, there are really no or very few factual disputes. And there is no question that Chapter 9H applies." (Tr. p. 23, ll. 1-19).

The State contends that when Stoecker Farms was created, it was created by Smithfield and its legal team; the money stayed and went with Murphy's, ultimately to Smithfield; and that Smithfield asks the Court to look at form over substance (Tr. p. 25, ll. 14-19). The State requests the Court to do the opposite; to look at substance over form.

In argument, the State did not contend that these are fraudulent conveyances; it agrees the documents are, in fact, what they purport to be. But the State asserts that through numerous permutations of this agreement, and constant tweaking, that Smithfield kept doing what was necessary to avoid another judicial order and any adverse application of Chapter 9H (Tr. p. 25, ll. 20-25; p. 26, ll. 1-10).

And the State finishes by stating that throughout all this, all its twists and turns, that Smithfield retains the money (Tr. p. 26, ll. 11-25). The State suggests that Smithfield's "control" was direct and the revenue stream, the profit, is the important distinction; that you can have all the language and legal maneuvering, but you control feedlots in Iowa by directing and controlling the revenues that flow from those feedlots (Tr. p. 28, ll. 9-18). In argument, assistant IAG Allen stated, in response to Smithfield's posture, that "yes, you've done all that you need to do. You've created the shell, but where is the yolk? The yolk goes to Smithfield. Always has, and always will go, no matter how many times they change this deal." And the State argues that Iowa is the premier place to raise hogs; feed and transportation costs are cut; there is a premium in Iowa; and you can earn good money raising swine. "That's why Smithfield wants to come here." (Tr. p. 29, ll. 21-25; p. 30, ll. 1-3).

The State contends that the equitable powers of this Court should disallow Smithfield to shave off a thin veneer of that corporation, establish Stoecker Farms (now Prestage-Stoecker Farms), create that shell, retain all its economic benefits, and send all the money to North Carolina. The State argues that should not happen under Chapter 9H and directing the revenue stream is the essence of operating a feedlot (Tr. p. 30, ll. 9-25).

Prestage-Stoecker Farms argues that Lam's finding in #60 is *fait accompli* as the Court has accepted that fact: that Prestage-Stoecker has its own set of books and maintains corporate formalities; it has engaged its own auditor, although it is the same auditor as employed by Smithfield, the auditor has opined that P-S Farms is an independent entity as a necessary ethical consideration for it to be an auditor for both; there is no evidence that Smithfield/Murphy pressured or exerted influence on Stoecker or Prestage; that 9H makes no reference to "revenues"; that Smithfield/Murphy cannot exercise financial leverage over P-S Farms because Prestage has the resources to pay off those debts; that the investment by Prestage was done for his own economic return; that the present company has a \$2 million line of credit available to it;

and the special master's findings at #37, 47, 48, 51, 52, 57, 65 all reflect the independent character of P-S Farms (Tr. pp. 25-50).

Attorney Malloy aptly pointed out, that by stipulation it was agreed that the Murphy Family Farms operation was not in violation of Chapter 9H before its sale to Stoecker and nothing significantly has changed since. Malloy views the actions of Stoecker Farms as being attempts to comply with the statute, not to avoid the statute, although admitting that is a subtle distinction (Tr. p. 55, ll. 1-25).

Smithfield, in argument, asserts that it is not a matter of complying or avoiding the statute; rather, it was an effort on the part of Smithfield/Murphy to comply and not to offend the temporary injunction enjoining Smithfield from acquiring the Iowa assets of Murphy; that it was in the final phases of acquiring Murphy's assets; Smithfield was anxious to close its deal and so was Murphy; Murphy was not a processor and was in compliance with Chapter 9H; Randall Stoecker was one of the best swine production men in the country; that by the transaction the grower contracts and the IBP contract are no longer the property of Smithfield/Murphy; and there is a stipulation, one and a half years after the transaction, wherein IAG agreed that Smithfield *had not* been involved in the manufacturing, processing or preparation for sale of pork products to that date in Iowa.

Smithfield/Murphy concludes, when one takes these facts and adds to it Lam's findings (there is no evidence of any "direct or indirect control or influence by Murphy/Smithfield over Prestage-Stoecker Farms' operation"), then the book and chapter is closed, and everyone can all go home resting comfortably that neither the Court's injunction or Chapter 9H is being violated. (Tr. pp. 59-62).

Smithfield contends that it is not controlling revenues, but merely receiving these revenues without the ability to control the costs that deplete those same revenues (Tr. p. 66, ll. 8-23). Smithfield views this as a cost plus contract which is common in agriculture since many businesses don't wish to take on the dynamic risks and the volatility of the hog market (Tr. p. 66, ll. 24-25, p. 67, ll. 1-19). Zirkle pointed out an IAG opinion that defined vertical integration as the ability of a processor to control two or more steps in a production and distribution chain; and Smithfield is not controlling the production off the feedlot, nor is it slaughtering the hogs. It is selling pigs to an Iowa farmer from its sow farms outside the state, and that's it! (Tr. p. 69, ll. 1-13). Smithfield asserts that in order for the statute, by its terms, to encompass its present role,

the statute would need to prohibit the sale of feeder pigs by a processor to a grower (Tr. p. 70, ll. 9-12). Or the statute would have to prohibit a processor from getting any economic benefit out of what happens in an Iowa feedlot (Tr. p. 70, ll. 13-21, p. 73, ll. 1-4). Smithfield concludes by stating that it is not controlling what happens in the feedlots and it is not controlling the costs (Tr. p. 80, ll. 4-10).

The State responds that circumstantial evidence shows that Randall Stoecker is a Smithfield employee; Bill Prestage is on its board of directors; that control by them is tantamount to control by Smithfield; though P-S Farms could buy its own feed, it doesn't; that it could hire its own employees, but it continues to contract with Murphy; though it can go out and buy pigs somewhere else, it hasn't; Smithfield could have bought Murphy Family Farms and excepted the Iowa assets, but it selfishly wanted the substantial economic benefit; and it has left Iowans with the flies and odor (Tr. pp. 81-86). Smithfield responds alleging there is no public policy or statutory provision in Iowa that prevents a pork processor from making a profit on the sale of hogs to be finished in Iowa (Tr. p. 88, ll. 23-25, p. 89, ll. 1-2).

* * *

The Court concludes that the appropriate burden of proof is a mere preponderance.

The State does not ask the Court to pierce the corporate veil (Tr. p. 22, ll. 1-3). It asks as a remedy that the Court find that Smithfield/Murphy is in violation of Chapter 9H, and that the Court, upon declaring the transaction(s) a "sham," that it divest the assets from any control, including the receipt of revenues, by Smithfield (Tr. p. 90, ll. 3-13).

Team Central v. Teamco, Inc., 271 N.W.2d 914, 923 (Iowa 1978), helps answer this question. Teamco was a franchisee, and Team Central its franchisor for the sale and distribution of electrical equipment. Team Central was wholly owned by Dayton-Hudson. A dispute arose over an open account for over \$150,000. Teamco counterclaimed for tortious interference. It brought a cross-petition against Dayton-Hudson. It alleged Dayton-Hudson was responsible for the conduct of Team Central as it was a mere sham and conduit for Dayton-Hudson. The jury so found and held Dayton-Hudson financially responsible for any recovery against Team Central. The Court said "that the corporate veil doctrine is most frequently applied to avoid fraud. However, it is equally appropriate under other circumstances when one corporation is used as a mere sham for the other." The burden was a preponderance in Teamco. Though the State is not

asking that the veil be pierced, it alleges a sham which, according to Teamco, does not require fraud; i.e., only that it does not have a "real independent existence."

There are a host of cases that deal with a corporate "sham." Westcott & Winks Hatcheries v. F.M. Stamper Co., 85 N.W.2d 603, 607 (Iowa 1957), states the corporate entity will be disregarded only where used as a cloak for fraud or illegality . . . or when used as a subterfuge to defeat convenience, justify wrong, or perpetrate a fraud." Some other cases are Lakota Girl Scout v. Haver Fund-Raising Management, 519 N.W.2d 634, 639 (8th Cir. Ia. 1975); Fazio v. Brotman, 371 N.W.2d 842, 846 (Iowa 1985); Briggs Transportation v. Starr Sales, 262 N.W.2d 805, 810 (Iowa 1978); Inn Operations v. River Hills Motor Inn, 152 N.W.2d 815 (Iowa 1967); and Wade v. Central Broadcasting, 288 N.W. 441, 443 (Iowa 1939). These were all decided by a preponderance and distinguish a "sham" from a fraud.

In In re Marriage of Goodwin, 606 N.W.2d 315, 321 (Iowa 2000), the dissolution court found a transfer of a vehicle, pursuant to our motor vehicle transfer laws, a sham, again by the same burden as the remainder of the dissolution issues.

Preponderance alone is the appropriate burden.

* * *

Proceeding on the "sham" issue, the Court has analyzed Kindy and Plymouth. The State asserts these two cases are a fortress for its position.

Kindy Optical Company was a Delaware corporation. It was not licensed to practice optometry in Iowa. Kindy leased an optical department from Younkens. It entered into a lease for those quarters with W. O. Jensen, a licensed optometrist. Jensen, before coming to Des Moines, had managed, as an employee, similar businesses for Kindy in four other states and in Sioux City. Kindy agreed to pay Jensen, as the lessee, a monthly sum. The lease provided that all eye examinations would be under the exclusive control of Jensen. On the same day, Kindy and Jensen entered into a written contract of employment wherein Jensen would be the manager of the optical department, but "shall be subject to the control and directions of the proper officers of Kindy." The contract provided that all monies would be deposited in the Kindy account and all disbursements shall be paid by checks drawn by Kindy. This contract provided for a salary to be paid Jensen. All the machinery and equipment installed and used in the business was the property of Kindy and all the accounts were handled through Younkens. Kindy's name did not appear in any way in this business. The advertisements appeared in the name of Younkens, but

prepared by Kindy. The money received by Jensen for eye examinations, to the extent of the rentals and salary owed him, would be retained by him before depositing the receipts to Kindy. A guaranty relating to the results of the eye examinations, a part of the advertising plan, was the responsibility of Kindy and not Jensen.

Our court commented at p. 335, as follows:

"It is true that the name of the defendant did not appear in connection with the business. The business was advertised in the newspapers in the name of Younkers, but the record shows that these advertisements were all prepared by the defendant, inserted in the newspapers, and paid for by the defendant; the guaranty . . . was the guaranty of the defendant company. . . This guaranty was a part of the advertising plan of the defendant company. The ownership and control of the entire equipment of the Des Moines office was in the defendant, and not in its employee. Its officers determined all its policies. The subtle attempt on the part of the defendant to evade the provisions of the Iowa statutes in reference to the practice of optometry, by employing a licensed optometrist to conduct its business, and by the execution of the alleged lease with its employee, is too patent to appeal strongly to a court of equity. . . The execution of the so-called lease between the defendant and Jensen, in connection with the contract of employment between the same parties, was also a sham and fraud, and a too evident plan, purpose and intent to evade the provisions of the statutes herein referred to. It is true that the name of the defendant did not appear publicly in connection with the business, but the record shows without controversy that the business was in fact owned and operated by the defendant company. The defendant company controlled the conduct and policies of the business. Jensen was simply its employee on a stipulated salary. The so-called lease between Jensen and the defendant, under the terms of which the defendant, as lessor, was to pay Jensen, as lessee . . . was only a clever attempt to change the character of Jensen from an employee to a lessee, and does not change the fact that Jensen was an employee of the defendant company. The defendant company could not conduct the business without a license. It could not obtain a license, and we can conceive of no reason why it should be permitted to continue to conduct a business under the license of an optometrist."

Plymouth Optical Company had its principal place of business in Minneapolis. It controlled three wholly-owned subsidiaries, which were Iowa corporations. The assets and trade name of Morgan Optical Company, owned by Dr. Morgan, were purchased by these corporations. Morgan, a licensed optometrist, rented space for offices from the Plymouth corporations, and he and his associates performed eye examinations and kept their own fees. After the State initiated an action to enjoin the corporation, Morgan abandoned his rental arrangement. The defendants then leased the office space to Dr. Alshouse, a licensed optometrist. The contractual arrangement was embodied in a written agreement to lease all the equipment and office furniture in each location for a five-year term with the renewal option for

an additional five years. The optical offices were in five cities. The defendant contended that the relationship was that of landlord-tenant. But the Plymouth court affirmed the trial court, permanently restraining Plymouth from the practice of optometry. It found important the agreement provided that Dr. Alshouse was required to place in escrow, for the benefit of the defendants an assignment of all employment contracts between him and other optometrists working in other optical outlets in Iowa. These assignments vested in the defendants, all of Alshouse's rights in the employment contracts in the event of breach or default by him. The court found important that the agreement, if default occurred, at least potentially placed the defendants in the practice of optometry. The court found important the testimony of a licensed optometrist in the Iowa City store that he had never had any contact with Dr. Alshouse, presumably his employer, but had been retained by the vice-president of Plymouth. Alshouse was contractually obligated to employ the services of the same bookkeeper as the defendant, who maintained joint control over all bank accounts; he was further required to employ the services of an advertising agency selected by the defendants, to contribute to the cost of that advertising, though he had no control over it; and two checks were revealed that were payable to counsel for the defendants by Alshouse without explanation. The court determined that the defendants exercised improper dominion and control over the defendant doctor to the extent it was engaging in the practice of optometry.

But neither Kindy or Plymouth are the trump cards that the State contends they are. In Kindy there were a multitude of facts that showed continued control. The lease called for payment by the lessor to the lessee; the employment agreement called for the manager to be subject to the control and directions of the employer; the monies deposited and disbursements made were by Kindy; the equipment was Kindy's; advertisements were prepared by Kindy; the guaranty of workmanship was by Kindy; the conduct and policies of the business was controlled by Kindy; and the lease was a feeble attempt to change the character of Jensen from an employee to a lessee. One did not need to be another Justice Cardozo to find that Kindy was practicing optometry. It further appears our court, although calling the lease a sham, did not actually find the entire scenario a "sham." The Kindy court reversed the trial court, in equity, and found, under all these circumstances, that it should not be permitted to continue to conduct the business under the license of an optometrist, as it was engaged in optometry itself.

The Plymouth case affords little aid to the State's cause. "Sham" was not mentioned in it. The facts clearly showed that Plymouth and its subsidiaries were, in fact, practicing optometry and had an abundance of control. Each of these cases bears facts that are substantial stronger, to show control, than the present set of facts.

Although the State is not asking that the corporate veil of P-S Farms be pierced or found to be a fiction, it relies upon similar allegations of fact to find and argue the existence of a sham. It states that Stoecker Farms' purpose and its very existence as a corporation is completely intertwined with this transaction. Stoecker Farms was incorporated as an entity by Smithfield's attorney to effectuate Smithfield's need to transfer Murphy's Iowa assets, yet retain all the revenues generated by those assets." (Brief p. 25) It recites that the metamorphosis began with the purchase and financing of existing assets; a pig-raising deal, not a debtor-creditor relationship; followed by the purchase and financing of replacement pig inventory, reciting that Smithfield received \$136 million in 2000 under the pig agreement, and Stoecker Farms retained only \$527,000; purchasing the feed mill; entered into a service agreement for its employees to perform services for Stoecker Farms; transferring the grower agreements; transferring IBP's marketing agreement; and making changes to the deal by reducing the inventory note by \$14 million; consenting to the buy-back of the feed mill; Stoecker increasing his capital contribution from \$10,000 to \$500,000; amending its secured note; and selling part of Stoecker Farms to a huge North Carolina hog producer, also on the board of Smithfield. (Brief, pp. 7-17)

This Court admires the zeal of the IAG in tenaciously attempting to remedy what it perceives as another nail in the coffin of our state's family farms. Unfortunately, as a court in equity, the interpretation given Chapter 9H is determined by what the legislature said, not by what it might have said. Perkins v. Madison County Livestock & Fair Association, 613 N.W.2d 264, 269 (Iowa 2000). "To ascertain legislative intent, the Court looks to what the legislature said. The Court does not speculate as to the probable legislative intent apart from the words used in the statute." Perkins, supra; State ex rel Miller v. Midwest Pork L.C., 625 N.W.2d 694, 699 (Iowa 2001).

Along those lines, this Court's mandate is to interpret Iowa Code section 9H.2, not to rewrite it. The Court must respect the separation of powers; the legislature enacts the laws, and the court enforces/interprets them. As tempting as it may be, this Court must stay within its judicial parameters.

The language chosen by the legislature prohibits ownership, control or operation of feedlots in Iowa. Smithfield does neither. True, their brain-trust, and their able lawyers have been able to hone a relationship with their employee to create a legal creature that allows it to continue the sale of feeder pigs in Iowa, and to obtain the earnings from them (except for a quarter a head), though still assuming the risk. The legislature did not opt to use words such as "directly or indirectly," nor did it choose to expressly forbid the financing, extension of credit, or a processor's sale of feeder pigs to an Iowa feedlot. Smithfield has tailored its agreement, whatever its purpose, to obtain the spoils by the soliciting and financing of a person it can trust and one that was continually amenable to changing the deal, so long as it continued to be good for him.

The legislature was aware of the use of the words "directly or indirectly control," as it used them in the very same statute in the following sentence referencing the contract feeding of swine. But it did not choose to use "indirect" [control or operates] in the subject provision. That shows, by what it said, that the legislature did not intend to ban this type of deal.

And it was done and accomplished in such a manner that the special master, after numerous depositions, reviewing all the conduct and a wealth of documentary evidence, found that there was no evidence of any "direct or indirect control or influence" by Smithfield/Murphy over Stoecker Farms (now P-S Farms, Inc.). There is not a preponderance of evidence to show that P-S Farms, Inc., has no real, independent purpose or existence. Similarly, in Midwest Pork, the Court found that Austin DeCoster did not violate the code section or statute that prevented him from constructing or expanding confinement facilities by financing them for a corporation owned by his son.

In Iowa Comprehensive Petroleum v. Mobil Oil, 606 N.W.2d 359, 366 (Iowa 2000), our court defined "control" as not only the actual exercise of control, but the right or authority to control it; it is the right to control the means of performance, not the end result of the performance. In Mobil I, the Court found that the right of Mobil to terminate its gasoline supply to the station and to debrand the station for using another brand and/or failing to pay for the gasoline, does not make it in control. Iowa Comprehensive Petroleum v. Mobil Oil, 606 N.W.2d 367 (Iowa 2000) (Mobil II), made a similar finding, even though Mobil had similar abilities to terminate, plus others.

Smithfield has a presence in Iowa as it sells feeder pigs to its employees' corporation, with whom it contracts for labor and feed besides. But that is not against the statute. P-S Farms has an independent existence. And our special master has found no indirect control or influence. True, it was a delicate but shrewd way to comply with this Court's temporary injunction and to avoid violating the statute, but it is not prohibited by that statute.

With the stipulations by the State that Murphy Family Farms, at the time of the transaction, was not in violation of 9H; that Stoecker Farms continues to feed, without material change; that Smithfield has not been involved in the preparation for sale of pork products from Stoecker Farms' swine (p. 10 hereof); that Smithfield/Murphy was not in violation of this Court's injunction; and the finding by special master Lam that there is no evidence of any direct or *indirect control* or influence by Smithfield/Murphy over Prestage-Stoecker Farms, together with the special master's other findings showing no sham (#37-65), this Court, whatever the burden, cannot find a sham to vacate these transactions. Nor will it find the defendants, circumstantially or otherwise, in violation of section 9H.2. If it swims like a duck, waddles like a duck, quacks like a duck, then it must be a duck. So here, it looks like a P-S Farms feedlot, it is owned like a P-S Farms feedlot, it is controlled like a P-S Farms feedlot, and it is operated like a P-S Farms feedlot; then it must be a P-S Farms feedlot!

Again, it is not what the legislature might have said, or what it intended to say, but rather what it intended by what it said. It said "own, operate or control a feedlot;" Smithfield/Murphy does not do either. Nor did the special master (whose facts this Court has accepted as proven) conclude that Smithfield/Murphy, directly or indirectly, controls or influences Prestage-Stoecker Farms. That shuts off the lights and satisfies this Court that there is no legal sham existent.

But as a message of caution and challenge to Smithfield Foods. Through the use of its resources, its ability to corral persons who it trusts, and to obtain legal absolution by carefully worded and planned transactions, it remains incumbent upon it to acknowledge its continuing responsibility, with Prestage-Stoecker Farms, to be a good and responsible neighbor and steward. Smithfield sells feeders annually to Iowa grossing more than most wholesale distributors in this state, no matter their trade. It annually supplies about 2 million feeder pigs to grow to maturity in Iowa and to be slaughtered in Iowa by Iowa packing plants. It must be acutely aware that these feedlots, which are the venue for its eventual profit, subjects our now-fragile environment to a test of strength; that our streams, rivers and aquifers are its potential targets, as well as our

clean air. Though the subject statute is framed in terms of free enterprise, prevention of monopoly, and consumer protection, its design is to also encourage good and responsible husbandry. Selling feeder pigs to Iowa growers is not completed in a vacuum. Growing is a natural and necessary descendant to that selling and its eventual profits. And, with its cost-plus contracts, it should acknowledge that some costs may be rightfully charged that tends to minimize and stabilize the effects of large scale confinement operations on our lives and natural resources. This is as much its equitable task as to sell a healthy feeder pig. Being foremost in its industry, this should be a continuing acceptable challenge.

* * *


The State has not proven by a preponderance of the evidence that a sham exists or a violation of Chapter 9H has occurred or is occurring.

* * *

Accordingly, the petition against the defendants, and each of them, is hereby DISMISSED. The State should forfeit all costs advanced; Smithfield Foods should pay any additional costs, clerk to assess.

The temporary injunction herein is QUASHED, effective immediately.

Dated February 5, 2002.


RONALD H. SCHECHTMAN, JUDGE
SECOND JUDICIAL DISTRICT

Clerk to provide copies to:

Iowa Attorney General (Allen, Moline, Reno)
Warren Zirkle/Richard Cullen
Brian P. Rickert
Robert P. Malloy